No. 87-36 (4)

IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

INVESTMENT COMPANY INSTITUTE and
SECURITIES INDUSTRY ASSOCIATION,
Petitioners,

v.

FEDERAL DEPOSIT INSURANCE CORPORATION, ET AL.,
Respondents.

REPLY BRIEF IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI

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1180

TABLE OF CONTENTS

TABLE OF AUTHORITIES

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Respondents' Brief in Opposition ("Opp."), as noteworthy for what it omits as for what is says, confirms that the requested Writ of Certiorari should issue. Respondents do not dispute that the refusal of the Federal Deposit Insurance Corporation ("FDIC") to give effect to the plain language of Section 21 of the Glass-Steagall Act presents profound questions of national importance with far ranging implications for all members of the nation's financial community (Opp. 1-13).

Nor do Respondents contest that, by issuing regulations authorizing the more than 9,000 insured nonmember banks in this country to engage in the securities underwriting and mutual fund businesses through subsidiaries, the FDIC has set in motion forces that may result in the complete realignment of the nation's banking system (Pet. 7-9).[1] Respondents do not even dispute that, in an attempt to control the widespread conflicts of interests and potential financial abuses that admittedly inhere in the newly

1. In fact, subsidiary banks of Citicorp, one of the world's largest bank holding companies, already have deserted the Federal Reserve System and have applied for state charters in order to take advantage of the "flexibility on Glass-Steagall" that "insured nonmember banks have won" under the FDIC rule under review. *Citicorp Seeks State Charter for Subsidiary; Investment Banking Laws Lure Bank, Goldome FSB*, Am. Banker, Apr. 21, 1987, at 1.

authorized activities, the FDIC assumed and exercised regulatory authority Congress expressly, deliberately and repeatedly has denied to federal banking agencies in an effort to construct from whole administrative cloth a regulatory framework of legislative magnitude reaching areas far beyond the agency's limited expertise (Pet. 9-10).

Instead, Respondents rely upon inapplicable statutory provisions and inapposite judicial authority to deflect review on the sole grounds that the FDIC's decision to reverse more than fifty years of consistent prior administrative construction and to authorize 9,000 insured nonmember banks to engage in the securities business through subsidiaries was correct on the merits. This argument fails for three simple reasons.[2]

First. Congress made its contrary intent plain—and hardly could have made it any plainer—by enacting Section 21 in order to forbid insured nonmember banks to engage in the securities business "to any extent whatever." 12 U.S.C. § 378(a)(1).[3] Although Respondents seek to divert attention from this plain statutory language through discussion of other statutory provisions governing the securities activities of *member* banks (Opp. 7-8), those provisions actually confirm the plain meaning of Section 21.

Section 16 of the Glass-Steagall Act (in conjunction with Section 5(c)) prohibits member banks from engaging directly in the

2. Respondents offhandedly suggest that review is not warranted here because of "the absence of a conflict in the circuits" (Opp. 7). Respondents fail to explain how that conflict is supposed to materialize when a court of appeals, in a challenge brought by the national trade associations representing the securities and mutual fund industries, has upheld a rule which by its terms is of nationwide application.

3. Although Respondents indirectly hint that Section 21 is applicable only to securities firms and not to insured nonmember banks, this contention is belied by the statute itself and by direct holdings of this Court to the contrary. *See* 12 U.S.C. § 378(a)(1) (first proviso); S. Rep. No. 1007, 74th Cong., 1st Sess. 16 (1935); *Securities Industry Association* v. *Board of Governors of the Federal Reserve System*, 468 U.S. 137, 147 (1984) ("*Becker*"); *Board of Governors of the Federal Reserve System* v. *Investment Company Institute*, 450 U.S. 46, 65 (1981) ("*Board of Governors*"); *Investment Company Institute* v. *Camp*, 401 U.S. 617, 639 (1971) ("*Camp*").

securities underwriting and mutual fund businesses. *See* 12 U.S.C. §§ 24 (Seventh), 335. Ever since 1933, both the Federal Reserve Board and the Office of the Comptroller of the Currency consistently have held that, while member banks may create subsidiaries, the subsidiaries are nothing but arms or departments of the banks and thus may not engage in securities activities which are forbidden to member banks themselves under Section 16. *See* 12 C.F.R. §§ 5.34; 250.14. Because Sections 16 and 21 are coextensive and seek "to draw the same line," *Becker*, 468 U.S. at 149, Section 16 reaffirms that Section 21 means what it says and prohibits insured nonmember banks from engaging in the forbidden activities "*to any extent whatever,*" whether directly or through subsidiaries. 12 U.S.C. § 378(a)(1) (emphasis supplied).

Nothing in Section 20, moreover, alters this conclusion. Section 20 constitutes a limited exception from the reach of Section 21 permitting member banks to affiliate with companies which are not "engaged principally" in securities activities. Although Respondents insist that Section 20 cannot be read as an exception to Section 21 because its terms are strictly prohibitory (Opp. 7-8), the error in this claim is revealed by Respondents' own position that Section 20 contains "'*permissive language* which *allows member* banks to establish affiliate relationships with firms doing some limited amount of securities work'" (Opp. 5, *quoting* Pet. App. 13a) (first and second emphasis supplied).

Equally important, any contrary construction of the interplay between Section 20 and 21 would stand the Glass-Steagall Act on its head. The legislative history of the statute documents that Congress intended the Act to encourage—if not pressure—all of the nation's banks to join the Federal Reserve System. *See, e.g.*, 77 Cong. Rec. 3727-28; 3903-04; 3907; 3909; 3911-12 (1933); (Pet. 17 n.26). To accept the FDIC's construction, however, is to conclude that, even though Congress intended the Act to achieve this goal, Congress at the same time created enormous incentives for insured nonmember banks to remain outside of the Federal Reserve System by exempting their subsidiaries from the

Act's prohibitions. Respondents understandably cite no support for this novel proposition, and none exists.

Second. The footnote dictum in *Board of Governors* relied upon by Respondents (Opp. 9-10) provides no support for the FDIC's unprecedented rule. Apart from this Court's repeated instructions that it does not decide major issues of law in footnotes,[4] the Court in *Board of Governors* merely upheld the Federal Reserve Board's ruling that it was "closely related to banking" within the meaning of Section 4(c)(8) of the Bank Holding Company Act for bank holding company affiliates to serve as investment advisers to closed-end investment companies. Because the Court determined that banks could perform the same activities without violating the Glass-Steagall Act, *Board of Governors, supra*, 450 U.S. at 59, 62, the decision plainly is inapposite where, as here, the FDIC concedes, *see* 49 Fed. Reg. 46,709, 46,710 (1984), that the 9,000 insured nonmember banks affected by the Rule are legally barred from directly engaging in the mutual fund and securities underwriting businesses.

Moreover, the *Board of Governors* decision actually supports the petitioners' position here. For, in *Board of Governors* the Court instructed that bank affiliates could engage in securities activities prohibited to banks by the Glass-Steagall Act only where Congress (and not an administrative agency) has specifically authorized that result by statute—specifically identifying Section 20 of the Glass-Steagall Act as one such example. *Board of Governors*, 450 U.S. at 60 & n.26. The FDIC concedes, however, that neither Section 20 or any other permissive statutory authorization is applicable here.

Third. Contrary to the claims of Respondents (Opp. 12), petitioners' complaint here is not that the FDIC erred in failing to impose greater restrictions upon the securities subsidiaries of insured nonmember banks. The error lies in the FDIC's unilateral assumption of authority to substitute its view of the desirability and efficacy of transitory administrative regulation for

4. *See, e.g., Kovacs* v. *Cooper*, 336 U.S. 77, 90-91 (1949) (Frankfurter, J., concurring); *Hutcheson* v. *United States*, 369 U.S. 599, 632 n. 8 (1962) (Warren, C.J., dissenting).

Congress' considered legislative judgment that the potential hazards and abuses inherent in bank participation in the securities business demand flat structural legislative prohibitions.[5]

The instant case, moreover, highlights the dangers in permitting *ad hoc* administrative assessment of the risks inherent in bank securities activities and case-by-case agency determination of the appropriate response. The FDIC represented to the court of appeals, as it does to the Court here (Opp. 4), that strict adherence to the Glass-Steagall Act's prohibitions is unnecessary because the agency has taken steps to restrict "potentially risky bank activities." Once the court of appeals upheld that FDIC's rule, however, the agency commenced rulemaking proceedings to eliminate the very restrictions upon common bank-securities subsidiary names, entrances and facilities that the FDIC previously had imposed and defended as necessary to ameliorate the hazards that prompted Congress to enact the Glass-Steagall Act. *See* 52 Fed. Reg. 11,492 (1987). And, in the event this Court were to deny certiorari, of course, there would be nothing to prevent the FDIC from further weakening or even dismantling the remainder of its administrative admonitions, leaving Congress' flat structural prohibitions and the "strong prophylaxis" thereby intended in tatters. *Becker*, 468 U.S. at 148.[6]

CONCLUSION

The opinion below, if allowed to stand, will almost certainly signal to lower courts and federal regulators an abdication of the

5. Although Respondents claim that the FDIC rule does not constitute a reversal of longstanding agency precedent (Opp. 11-12 n. 8), the record reflects that the FDIC never had permitted insured nonmember banks to engage in the securities underwriting and mutual fund businesses through subsidiaries until the issuance of the rule under review (Pet. App. 194a). The very novelty of the FDIC's ruling, and the abrupt about-face it embodies, themselves provide significant evidence of the rule's illegality. *Becker*, 468 U.S. at 153-54. *See also BankAmerica Corp.* v. *United States*, 462 U.S. 122, 130-32 (1983).

6. Respondents' citation (Opp. 11) to the temporary moratorium provisions of the Competitive Equality Banking Act of 1987 ("CEBA"), Pub. L. No. 100-86, 101 Stat. 552, provides no answer. Apart from the fact that the moratorium provisions expire by their terms on March 5, 1988, CEBA expressly codifies Congress' commitment not to renew them upon expiration. *See* Section 203, 101 Stat. 584.

judiciary's duty to prevent the administrative dismantling of the fundamental and longstanding expression of national banking policy embodied in the Glass-Steagall Act. Absent action by this Court, bank regulators are likely, as here, to authorize activities in their view of the public interest that Congress deliberately has prohibited (Pet. 9-12) and to assume policy decisions of enormous economic significance that properly may be made only by Congress. This Court's intervention thus is critical to make clear that "there are limits * * * on how far an agency may go in its interpretive role," *International Brotherhood of Teamsters* v. *Daniel*, 439 U.S. 551, 566 n.20 (1979), and to reaffirm that, if existing banking statutes are not deemed to serve the public interest, "that is a problem for Congress, and not the [banking agencies] or the courts, to address." *Board of Governors of the Federal Reserve System* v. *Dimension Financial Corp.*, 106 S. Ct. 681, 689 (1986).

Respectfully submitted,

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